



# THE CASE FOR REFORMING OUR STATE PORTFOLIO

BY STATE TREASURER CHIP FLOWERS

As part of the Delaware State Treasury's efforts to address the poor performance of the state's investment portfolio, this office has secured an independent report from a leading financial institution that provides a detailed explanation for why the portfolio managed by the Cash Management Policy Board is underperforming. Since the release of that report last month, some critics in government have implied that the portfolio's poor performance is actually the result of shrewd financial prudence. A clever argument, but I strongly disagree.

Upon entering office in January 2011, we inherited a falling portfolio that generated historic lows in interest. Our treasury maintains over \$1.6 billion daily, invested in safe securities for up to 10 years. Only on rare occasions is the state's invested income used to pay our bills. Over the past five years, the independent report found, the portfolio not only failed to keep pace with inflation, it also performed below the average of similar states having a "AAA" credit rating or similar amounts invested. In fact, in 2011, the state's \$2 billion portfolio returned less than 1% (about \$8 million) in interest. By taking some basic actions, your treasury was able to increase this return by an additional \$4 million this fiscal year.

While some in government would have us believe that other fiscally sound states were wrong in taking action to protect their money and Delaware was right to "prudently" do nothing but watch its portfolio fall, this reasoning is flawed. It reminds me of when my sister received a less than stellar grade and attempted to convince my parents that the top-performing students were wrong for working hard. Her reasoning was flawed and so is the Policy Board in its attempt to bring down the hard work of others to justify their actions that resulted in below-average performance. In short, in difficult economic times, Delawareans deserve a portfolio that is actively managed to avoid poor performance.

We can do more. We can do better. We can start by acting on key recommendations provided to the governor, through the Policy Board, in the independent report.

First, we must hold those who manage our portfolio to performance measures. Under contracts signed by a prior treasurer, those who manage our state's money receive over \$2.1 million in annual fees without having to meet performance standards. This is not only poor practice, but it fails to create safeguards to ensure that our managers are earning their money. Establishing benchmarks will enable the treasury to monitor performance and hold managers accountable.

Second, we can achieve higher returns while lowering or maintaining current portfolio risk levels. With better management and proper diversification, our independent advisor concluded, we can increase the returns of a large part of our state portfolio to 3.20% without increasing risk. While this percentage may seem small, it could translate into millions in extra interest on the portfolio. Furthermore, better diversification would protect the portfolio from the negative impact of future increases in interest rates.

Finally, we must have open and competitive contracts in selecting those who manage our portfolio. Despite the portfolio's below-average performance, at the request of the governor and his administration, language was inserted into the current state budget that allows the Policy Board to extend the current lucrative manager contracts without going through the state's bid process. This action actually rewards poor performance with taxpayer funds. The treasury will continue to promote an open and competitive process to select the best firms.

While I understand the governor, his administration and members of the Policy Board feared taking action during the midst of the financial crisis, such continuing failure to act, in contrast with other states, is preventing us from lowering risk and increasing returns. Disagreeing with the Goliaths of government may have serious retaliatory consequences (i.e., cuts in the treasury's budget or threats to eliminate this independent office). However, every now and then Davids come along, standing firm and supported by the collective strength of the People, and change the course of our future for the better.